

# Japan's protection racket

How much do barriers to imports cost Japanese consumers?

**M**ENTION Japan's trade barriers to its trading partners, and they will leave you in no doubt about their effects. They will point to firms in their countries that cannot prise their way into Japanese markets, and lament the profits and jobs that are lost to protectionism.

Such moans are understandable. And yet a hefty chunk of the cost of Japanese protection is paid not by foreigners, but by the Japanese themselves. Trade barriers, which raise the price of foreign goods or keep them out altogether, force consumers to buy more costly domestic alternatives. They also distort firms' inputs, pushing them towards expensive local sources and raising the prices of goods made at home. Indeed, the most persuasive argument for scrapping trade barriers, in Japan or anywhere else, ought to be that they damage protected economies.

So much for the theory. But how much does Japan really pay for its own protection? In a new book\*, three Japanese economists, Yoko Sazanami, Shujiro Urata and Hiroki Kawai, provide an answer. The calculation is tricky. It is not enough to assess the effects on prices of conventional trade barriers, such as tariffs and import quotas: Japan's trading partners often complain that informal barriers, such as government guidance to firms, matter more.

Another approach is to compare the prices of the same goods in different countries. Trade barriers push up prices in countries that protect their local producers. But in practice it is hard to find identical goods in different countries. Furthermore, price differences will reflect more than just trade barriers: exchange rates may be misaligned, or Japanese

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prices may be pushed up by inefficient distribution systems.

Ms Sazanami and Messrs Urata and Kawai use a different method: they compare the price of imports on the dockside (ie, before tariffs and wholesalers' mark-ups have been added) with the price of Japanese goods at the factory gate. They use the difference to estimate the cost of trade barriers to Japanese consumers.

They conclude that Japanese protection is limited to agricultural products and a few manufacturing industries. Where protection exists, though, it is heavy (see table). They estimate that in 1989 the prices of some foods were several hundred percent higher than import prices. Japanese-made radios and televisions were over 600% more expensive than imports. Clothing was marked up by nearly 300%; petrol by more than 200%.

### What price free trade?

The cost to Japanese consumers totals around ¥15 trillion a year (\$110 billion at 1989 exchange rates), or 3.8% of GDP. The cost to the Japanese economy as a whole is a good deal smaller, because protection earns profits for domestic producers and tariff revenues for the government. But the estimated damage is still hefty, at about 0.6% of Japanese national income. Moreover, say the three economists, these numbers may understate the costs of protection. More foreign competition would force Japanese industry to become more efficient: costs and prices would fall.

These figures are certainly striking. But it would be a mistake to place too

much weight on them. One reason is that the calculations attribute all of the difference between the wholesale prices of imports and of domestic goods to trade barriers: because of Japan's low tariffs, that means ascribing virtually the entire gap to non-tariff barriers.

But there could be other explanations for at least part of the gap. As the authors themselves point out, Japanese goods and imports are not perfect substitutes. Most televisions imported into Japan are basic models from other Asian countries; Japanese sets are usually more sophisticated and so should cost more. Without sorting out how much of the price gap is accounted for by quality, the effects of protection cannot be accurately assessed.

Furthermore, changes in exchange rates will affect the estimated cost of protection. Since 1989, the yen has appreciated by some 40% against the dollar (see chart): that should have cut the price (in yen) of imported goods. Meanwhile, factory-gate prices have barely changed. Thus, as the authors say, the cost to consumers of import restraints has probably risen, because consumers have not been able to benefit from lower import prices. But if, as many economists argue, the yen is overvalued, in the long run the cost of protection should fall even if trade barriers are unchanging. The estimated cost will thus vary with the period studied.

Another snag is that the prices of imports are affected by trade restraints. By making imports scarcer, they create monopoly power for foreign suppliers (as long as imports and domestic goods are not perfect substitutes). This enables them to charge higher prices for their wares in countries that protect local producers.

In a recent study†, Michael Knetter, an economist at America's Dartmouth College, argues that German exporters of a wide range of goods, from beer to blouses, charge far more in Japan than they do in America, Britain or Canada. And, he reckons, the price gaps cannot be explained either by differences in product quality or by the smaller scale of exports to Japan. The conclusion for Japanese consumers (and policy-makers) is a sobering one: trade barriers do not only push up the price of Japanese goods; they probably make imports dearer as well.

\* "Measuring the Costs of Protection in Japan". By Y. Sazanami, S. Urata and H. Kawai. Institute for International Economics, 1995

† "Why Are Retail Prices in Japan So High? Evidence from German Export Prices". By M. Knetter. National Bureau of Economic Research Working Paper 4894, October 1994

### The price of insularity Japan's:

trade barriers			
Difference between price of domestic goods and imports, 1989, as % of import price			
	Price difference	Tariff rate	Implied non-tariff barrier rate
Milled rice	737.1	0.0	737.1
Tea and coffee	718.4	11.9	706.5
Cosmetics	661.6	2.0	659.6
Radio and TVs	607.0	0.0	607.0
Wheat	477.8	0.0	477.8
Soyabeans	423.6	0.0	423.6
Clothing	292.6	10.4	282.2
Petrol	229.0	5.5	223.5

Sources: Y. Sazanami, S. Urata and H. Kawai; Datastream

